



Office of the Independent Budget Analyst

Review of the Mayor's Five-Year Financial Outlook for FY 2011-2015

Special City Council Meeting of
October 7, 2009



Overview

- Mayor's Five-Year Outlook for FY 2011-2015 represents 4th iteration in series of long-term outlooks
- Continues to project significant deficits in each year
- Gloomier forecast than in past years; FY11 deficit of \$179 million projected



Overview

- Overall, IBA concurs with the projections in the Five-Year Outlook
- Message is clear: San Diego is facing a dire financial situation
- A number of risks may result in larger deficits
- Few short-term options available other than budget reductions and service cuts



General Fund Revenue

- Mayor's Outlook reflects an increase of \$89 million, or 8%, over the 5-year period
- Incorporates revised FY 2010 projections, equating to a \$21.7 million decline
- Adjusts for \$39.2 million in FY 2010 one-time revenue
- Overall, projections are in line with current economic forecasts



Property Tax

- Outlook projects 0% growth in FY11, 2% in FY12, 3% in FY13 and 4% in FY14-15
- Assumes stabilization of housing market in FY 2011, with offsetting decline in the commercial market
- Concerns that the projection may be too optimistic in the near term



Property Tax

- Magnitude of impact that decline in commercial market will have is unknown
 - Tax roll shows 77% decline in sales and new construction of properties over \$50 million
 - Experts: Won't hit bottom for three more years
- In recession of early 1990s, property tax receipts did not recover for several years
 - Suggests a longer recovery period
 - "Low Growth" scenario may be more appropriate



Transient Occupancy Tax

- Outlook projects 1% growth in FY11, 3% in FY12, 3.5% in FY13, and 4% in FY14-15
- Based on revised FY10 growth of -4.0%, following an 11.4% decline in FY09
- Overall, reflects conservative assessment consistent with ConVis Travel Forecast
- However, FY10 projection may not be conservative enough



Salaries & Wages

- Outlook includes no salary increases or restoral of 6% reduction in FY 2010
- Vacancy Savings
 - Current level continues and then is reduced
- Accrued Leave Liability
 - Increased estimated costs for payment of accrued leave as employees leave City; grows to \$16 million in FY 2014



Fringe Benefits

- Outlook assumes no increases for fringe benefits other than pension and OPEB costs
- No increases assumed for Flexible Benefits
 - However, Buck Consultant's report suggests large annual increases in health care costs
 - Could result in negative impact to employees or increase costs to the City



Pension

- Estimated UAL for June 30, 2009 is \$2 billion
 - Up from \$1.3 billion at June 30, 2008
- FY 2011 ARC estimated at \$224.8 million
 - Increase of \$70.6M from \$154M in FY 2010
 - General Fund contribution of \$182M, up \$57M
- Includes \$39.1 million (\$31.7M GF) for McGuigan settlement



Pension

- Estimated FY 2011 ARC does not reflect potential impact of:
 - Negotiated pension plan changes
 - Salary freezes
 - Other changes effective July 1, 2009
- Could have positive impact on ARC
- Final valuation and ARC to be provided in December



OPEB – Retiree Health

- Outlook includes \$62.2 million for FY 2011
 - “PAYGO” portion is \$37.2 million
 - Prefunding portion is \$25 million
- City’s UAL for June 30, 2010 is estimated at \$1.36 billion
- FY 2011 OPEB ARC estimated at \$120.3 million
 - Outlook contribution equals 52% of FY11 ARC
 - Payment of the full ARC is not legally required, but is a prudent financial goal



Non-Personnel Expenditures

- Supplies & Services – 1.5% annual growth
 - Includes \$ for elections, removal of one-times
- Information Technology – 0% growth
 - Reflects decision to contract out
- Energy & Utilities – 5% growth
 - Consistent with prior Outlooks
- Equipment Outlay – 0% growth
 - Assumes tight spending controls



New Facilities

- New Facilities costs for 25.11 FTE totaling \$3.7 million have been included for Fire-Rescue and Park and Recreation
- Fire Station Master Plan – costs to address deficiencies not included
- Library Facilities Improvement Plan – costs to restart 2002 plan not included



Main Library

- Scheduled to open in FY 2014
- Outlook assumes no General Fund impact
- Library staff estimates an additional 1.00 FTE and \$2.7M needed for operations
 - Anticipated to be offset with \$2.8M in private donations and new revenue
- Any shortfall in donations could result in the need for additional General Fund support



Civic Center

- Outlook identifies four scenarios:
 - Two related to new construction
 - Two related to the continued occupancy
- Projected General Fund expenses range from \$1.3-\$33 million over five years
- Outlook includes \$5.6 million for CAB Fire Sprinklers,
 - No other capital outlays included to address Civic Center deferred maintenance



Fire & Police Academies

- Significant retirements in Police and Fire at end of FY 2009 led to unanticipated vacancies
- Current hiring freeze and cancellation of police and fire academies may result in additional vacancy savings
- IBA estimates \$19 million in additional savings for Police Department in FY 2010 over current \$20.7 million vacancy factor



Fire & Police Academies

- Estimated \$21.8 million in annual Police Dept. savings during Outlook period
- Estimated savings for Fire-Rescue Dept. close to budgeted vacancy of \$8.8 million
- If hiring freeze lifted, academies could be funded through department savings
- If hiring freeze remains, savings can continue to offset other funding categories



Deferred Maintenance

- Outlook proposes to secure new funding through the issuance of long-term debt
- Total of \$300M in net proceeds over five years assumed through three issuances
- Proposes refinancing the initial bonds executed in March 2009
- Debt service increases to \$9.5M in FY11, \$18.7M in FY12, and \$27.9M in FY14



Deferred Maintenance

- Condition assessments recently completed for Streets, Facilities, and Storm Drains
- Estimated backlog (excluding sidewalks & Civic Center):
 - \$688.1 million w/streets at 100% Acceptable
 - \$424.7 million w/streets at 75% Acceptable (industry standard)
- IBA recommends that the City Council discuss optimal street condition level



Reserves

- Outlook includes funding to meet and maintain all reserve policy goals
- Total of \$27.5 million required in FY 2011, declining to \$3.2 million in FY 2015
- General Fund policy goal to reach 8% by FY 2012
- Public Liability & Workers' Comp. policy goal to reach 50% of claims by FY 2014



Storm Water Compliance

- Outlook includes \$37.7 million per year for Storm Water compliance
 - No increase from FY10 Budget
- Storm Water Budget reduced by nearly \$12 million in FY09 and FY10
 - However, expected to remain in compliance with the current Municipal Permit
- New permit effective during Outlook period, may result in additional regulations



Risks to Outlook

- Property Tax Revenue Assumptions
 - Concern over slower recovery in housing market and decline in commercial sector
 - “Low Growth” scenario would result in a \$128.8M reduction over the five year period

| Property Tax Risk (in millions) | FY 2010 Forecast | FY 2011 Forecast | FY 2012 Forecast | FY 2013 Forecast | FY 2014 Forecast | FY 2015 Forecast |
|------------------------------------|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| Mayor's Outlook | \$ 391.6 | \$ 391.6 | \$ 399.4 | \$ 411.4 | \$ 427.8 | \$ 444.9 |
| <i>Growth</i> | -1.8% | 0.0% | 2.0% | 3.0% | 4.0% | 4.0% |
| Low Scenario | \$ 385.8 | \$ 380.0 | \$ 380.0 | \$ 383.8 | \$ 395.3 | \$ 407.2 |
| <i>Growth</i> | -3.2% | -1.5% | 0.0% | 1.0% | 3.0% | 3.0% |
| Difference | (5.8) | (11.6) | (19.4) | (27.6) | (32.5) | (37.7) |



Risks to Outlook

- TOT Revenue Assumptions
 - Concern that FY 2010 projection of -4.0% growth is still too optimistic
 - An additional 4.0% decline would result in a \$16.0M reduction over the five year period

| TOT Risk (in millions) | FY 2010 Forecast | FY 2011 Forecast | FY 2012 Forecast | FY 2013 Forecast | FY 2014 Forecast | FY 2015 Forecast |
|----------------------------|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| Mayor's Outlook | \$ 71.2 | \$ 71.9 | \$ 74.1 | \$ 76.7 | \$ 79.7 | \$ 82.9 |
| <i>Growth</i> | -4.0% | 1.0% | 3.0% | 3.5% | 4.0% | 4.0% |
| Risk Scenario ¹ | \$ 68.3 | \$ 68.9 | \$ 71.0 | \$ 73.5 | \$ 76.4 | \$ 79.5 |
| <i>Growth</i> | -8.0% | 1.0% | 3.0% | 3.5% | 4.0% | 4.0% |
| Difference | (2.9) | (3.0) | (3.1) | (3.2) | (3.3) | (3.4) |

¹ Assumes an 8 percent decline in FY 2010 receipts over FY 2009.



Risks to Outlook

- Salary Increases
 - Outlook assumes no salary increases or reinstatement of the 6% reduction in FY 2010
 - According to Outlook, each 1% increase would result in additional GF cost of \$5.2 million
 - Not realistic or sound business decision to assume no increases over the five-year period
 - IBA scenario assumes restoration of the 6% reduction over the Outlook period at a total additional cost of \$72.2 million



Risks to Outlook

- Salary Increases (cont.)

| General Fund Impact of Possible Salary Increases (in millions) ¹ | FY 2010 Budget | FY 2011 Forecast | FY 2012 Forecast | FY 2013 Forecast | FY 2014 Forecast | FY 2015 Forecast |
|---|----------------|------------------|------------------|------------------|------------------|------------------|
| Salaries and Wages Forecast | \$516.1 | \$512.1 | \$521.3 | \$527.5 | \$536.7 | \$523.1 |
| Increased Salaries and Wages | | | | \$533.8 | \$549.4 | \$548.9 |
| <i>Annual Percentage Salary Increase</i> | - | 0% | 1% | 1% | 2% | 2% |
| Increase to Salaries and Wages | - | \$ - | \$ 5.2 | \$ 5.3 | \$ 11.0 | \$ 10.5 |
| Increase to Fringe Benefits | - | \$ - | \$ 1.0 | \$ 1.1 | \$ 2.2 | \$ 2.1 |
| Subtotal Annual Impact | - | \$ - | \$ 6.3 | \$ 6.4 | \$ 13.2 | \$ 12.6 |
| TOTAL GENERAL FUND IMPACT | | \$ - | \$ 6.3 | \$ 12.7 | \$ 25.8 | \$ 38.4 |

1. Estimates assume an increase to fringe benefits of 20% of amount of salary increases for variable fringe benefit items. Typical fringe benefit rate as reflected in forecast ranges from 68% to 80%.



Risks to Outlook

- State Impacts
 - State action in FY10 to result in \$36M loss in GF property tax, and \$55M loss in tax increment for the Redevelopment Agency
 - Cities narrowly avoided losing Gas Tax
 - Likely that State will look to City funds again as deficits continue
 - Potential loss of \$24.6M (\$23.1M General Fund) in Gas Tax revenue is possible



Risks to Outlook

- OPEB PAYGO Contribution
 - Outlook projects PAYGO payment to increase from \$37.2M in FY11 to \$58.2M in FY15
 - Buck Consultants' projects PAYGO payments to be a cumulative \$52.7m higher

| Comparison of PAYGO Estimates | FY 2010 Budget | FY 2011 Forecast | FY 2012 Forecast | FY 2013 Forecast | FY 2014 Forecast | FY 2015 Forecast |
|-------------------------------|-----------------|------------------|------------------|------------------|------------------|------------------|
| Mayor's Outlook | \$ 32.1 | \$ 37.2 | \$ 42.3 | \$ 47.5 | \$ 52.9 | \$ 58.2 |
| Buck Consultants | 38.4 | 44.4 | 50.5 | 56.7 | 63.3 | 69.6 |
| Difference | \$ (6.3) | \$ (7.2) | \$ (8.2) | \$ (9.2) | \$ (10.4) | \$ (11.4) |



Risks to Outlook

- Storm Water Compliance
 - Current Storm Water Permit to expire in 2013
 - New Permit may impose new regulations, which may require additional GF resources
- Emergency Operations Center Relocation
 - Civic Center redevelopment proposal does not include new EOC
 - Costs to relocate and build a new EOC could be significant, though undetermined



Risks to Outlook

| | FY 2011 Forecast | FY 2012 Forecast | FY 2013 Forecast | FY 2014 Forecast | FY 2015 Forecast |
|--|---------------------|---------------------|---------------------|---------------------|---------------------|
| Five-Year Outlook Projected Deficit | \$ (179.1) | \$ (158.8) | \$ (155.9) | \$ (165.9) | \$ (136.5) |
| Risks | | | | | |
| Revenue Scenarios | | | | | |
| Property Tax | \$ (11.6) | \$ (19.4) | \$ (27.6) | \$ (32.5) | \$ (37.7) |
| TOT | \$ (3.0) | \$ (3.1) | \$ (3.2) | \$ (3.3) | \$ (3.4) |
| State Impacts | | | | | |
| Gas Tax | \$ - | \$ (23.1) | \$ (23.1) | \$ (23.1) | \$ (23.1) |
| Expenditures | | | | | |
| Potential Salary Increases | \$ - | \$ (6.3) | \$ (12.7) | \$ (25.8) | \$ (38.4) |
| Retiree Health PAYGO Estimates | \$ (7.2) | \$ (8.2) | \$ (9.2) | \$ (10.4) | \$ (11.4) |
| New Storm Water Regulations | TBD | TBD | TBD | TBD | TBD |
| Emergency Operations Center Relocation | TBD | TBD | TBD | TBD | TBD |
| Total: | \$ (200.9) | \$ (218.9) | \$ (231.7) | \$ (261.0) | \$ (250.5) |



Potential Solutions

- Delay Reserve Contributions
 - Delay the FY 2011 contribution to the Workers' Comp. and Public Liability reserves
 - Extend the timeframe for meeting the Workers' Comp. and Public Liability reserve policy goals by one year
 - Could result in FY 2011 savings of \$23.3 million
 - Would require reserve contributions to be made in FY 2015 to meet policy targets



Potential Solutions

- Delay Reserve Contributions (cont.)
 - FY 2008 CAFR: Reserve goals being reassessed due to the economic downturn
 - Council may wish to discuss status of reassessment with CFO, and any impact on credit ratings.



Potential Solution

- Unanticipated Vacancy Savings
 - City currently has around 800 vacant positions
 - Many the result of surge in FY09 retirements due to decrease in DROP interest rate
 - The additional unanticipated vacancies will likely reduce salary costs
 - Current hiring freeze could result in additional savings in FY11 and beyond, depending on length of the freeze
 - Could review vacant positions for elimination, which would result in permanent savings



Potential Solution

- **Managed Competition**
 - May result in savings over Outlook period, but unlikely to have major impact for FY11
- **Pension & Benefit Reform**
 - Significant potential savings, but long-term in nature and further analysis needed
- **New Revenues**
 - Previously discussed, but little political support; require voter approval



Conclusion

- Many past actions have been taken to move City toward financial health
- Without these accomplishments, fiscal challenges would be even more daunting
- However, City is facing historical General Fund deficits;
- Pension underfunding and negative impacts of recession are principle factors



Conclusion

- Largely concur with Outlook projections
- Identified a number of potential risks that may exacerbate deficits
- Few viable solutions available other than deep budget reductions and service cuts
- Given magnitude of the problem, process should begin immediately to identify core services and establish funding priorities